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SUBJECT: SINGAPORE ELECTRONICS SECTOR RECOVERING, BUT FUTURE IN DOUBT

¶1. (SBU) Summary: Singapore's electronics manufacturing sector is facing a transformative shift as it begins to recover from recession. The economic downturn gave a further push to a trend already underway as high-volume, lower value-added manufacturing departed Singapore for lower-cost producers in China and elsewhere. Although analysts say electronics manufacturing will not disappear, the sector will emerge from recession smaller and with a new focus. The industry is moving toward higher-end products that capitalize on Singapore's advantages in engineering talent, R&D facilities and the country's reputation for rule of law and protection of intellectual property. The GOS is focusing on attracting investment in new "green tech" industries like solar energy, and searching for new markets outside its traditional export destinations in the United States and Europe. End Summary.

#### Recession Short Circuits Electronics Sector

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¶2. (SBU) The financial crisis has hit Singapore's electronics manufacturers harder than other industries as consumers froze discretionary purchases and business saw no need to increase capital expenditures in the face of declining demand. Members of the Singapore Association of Electronics Industries told Econoff that sales began to slow last October, but fell off a cliff in November, and finally bottomed out in January and February. Electronics production was off nearly 45 percent in the first two months of this year compared to the previous year; exports fell by similar amounts.

¶3. (SBU) Although far from full recovery, the sector is showing signs of revival. Electronics output in June was off by 20 percent compared to last year, but was still the best showing for the sector in seven months. Exports were down 21 percent as well in June, but the latest release of the Purchasing Managers Index, an early indicator of upcoming manufacturing demand, was unexpectedly healthy for the electronics sector. New orders and new export orders are up for the third month in a row. Even employment stayed flat after months of contraction.

#### The Long Slow Decline

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¶4. (SBU) Despite the budding recovery, analysts say Singapore will be unable to slow a steady decline in electronics manufacturing that was well underway before the recession hit. Electronics has long been a major contributor to Singapore's economy, making up 22 percent of manufacturing employment (over 90,000 workers), and 30 percent of non-oil exports. Singapore still has the world's top three wafer foundries, 20 semiconductor assembly and test operations, integrated circuit design centers, and produces about 80 percent of the world's enterprise hard disk drives. However, production has been slowly shifting to China and other lower-cost countries since at least the mid-1990s, led by hard disc drives and

consumer electronics. In just the last five years, electronics output has dropped from 38 to 27 percent of Singapore's total manufacturing output. Electronics exports have not had a monthly gain in over two years. Motorola and Seagate, two major employers in Singapore, have each recently scaled down employment in Singapore and shifted some manufacturing elsewhere.

#### The Shift Up

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15. (SBU) Terence Wong, head of research for DMG Securities, told Econoff that electronics manufacturing was in Singapore to stay, but post-recession the industry would inevitably be smaller. Singapore suppliers have been moving manufacturing closer to companies in China that provide final assembly. Taiwanese companies, particularly contract manufacturers, have been challenging Singapore manufacturers at all levels. However, companies were hesitant to put all their manufacturing eggs in the China basket, and are therefore keeping some manufacturing in Singapore. Wong said the manufacturing that would survive would be the highest-end production that the Chinese have yet to develop the capacity to produce.

16. (SBU) Despite the strong competition, analysts say Singapore still has advantages that will continue to attract manufacturing. Damian Chan, Director of Electronics at the Economic Development Board (EDB), Singapore's investment promoter, told Econoff that although the cheap labor model is dead, Singapore's engineering talent keeps manufacturing here, providing trouble shooting and quality control superior to that in China. The advantage is particularly great for products that are mission critical and therefore less sensitive to price such as high-end servers. Superior R&D facilities and research technicians also anchor some

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manufacturing, necessary to conduct experiments and develop prototypes. Raju Chellam, a spokesman for Hewlett Packard, the largest electronics manufacturer in Singapore, pointed out that Singapore's tight rule of law attracted production with valuable intellectual property or subject to strict export controls.

#### Singapore Looks for the Next Big Thing

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17. (SBU) Although the GOS is trying to manage the reorientation of the electronics industry, EDB's Chan admitted that it was difficult to focus more than two years into the future. David Peck, owner of the medium-sized Arrow Technologies, told Econoff that he saw no new Next Big Thing on the horizon that would drive the next wave of electronics production. Earlier hot products like personal computers, laptops and cell phones ensured a steady supply of consumer demand for new electronics products, but no obvious new product is in sight that could drive similar demand.

18. (SBU) EDB is placing a bet on green technologies and alternative energy, particularly solar energy, as the next industry for Singapore. The GOS provided S\$350 million (US\$240 million) to develop research and manpower capabilities in the industry. EDB and the National University of Singapore provided S\$130 million (US\$91 million) to establish the Solar Energy Research Institute of Singapore (SERIS) to lead solar R&D in areas such as nano-structured solar cells and silicon photovoltaics. EDB managed to attract Norwegian solar manufacturer REC to build a US\$2 billion solar manufacturing complex, slated to be the world's largest. EDB is also looking at attracting manufacturers of portable power devices, i.e. fuel cells, and nanotechnology.

19. (SBU) EDB is also promoting Singapore as a site for regional headquarters for multinationals and local Singaporean firms to operate as a "control tower", supervising production, distribution, and managing supply chains in Asia. Chan said some Singaporean companies have moved manufacturing overseas but maintain much of the rest of their operations in Singapore, capitalizing on Singapore's reputation for quality but at the same time getting the "China price" for their manufactures. Singapore's low corporate tax rate is another incentive to keep income based here.

## Opening Markets

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¶10. (SBU) International Enterprise (IE) Singapore, the GOS's export promotion arm, is expanding its efforts to open up new markets, particularly for its small- and medium-sized electronics enterprises. In the face of declining sales in the United States and Europe, IE is subsidizing trade shows in new markets to spark interest in Singapore products. Thian Thai Chew, Director of Electronics for IE Singapore, told Econoff that Singapore companies were still finding demand in China, and IE was focusing on opening new markets in "Tier 2 and 3" cities in the hinterlands of China. China's new 3G telecom system and subsidies for rural consumers are driving a wave of electronics purchases in those areas. India is an interesting market, Chew said, but Singaporean companies were finding it difficult to get a foot in. IE has opened offices in India to lead the way, as well as in the Middle East, and has established a presence in Brazil to try to open markets in Latin America.

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